FEATURE

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The NAFTA Countries Build on Free Trade

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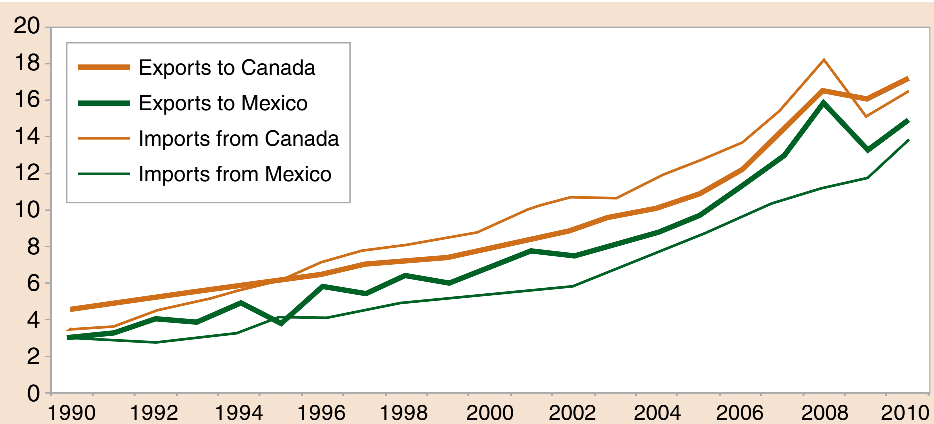
- The North American Free Trade Agreement (NAFTA) is now an integral part of the North American agricultural economy, though some cross-border bottlenecks remain.
- Efforts to strengthen agricultural trade under NAFTA are focusing on regulatory cooperation, long-haul trucking, dispute resolution in produce trade, and refining NAFTA's rules of origin.
- Recognizing market opportunities outside North America, each NAFTA country is seeking more open trading relationships with non-NAFTA countries.

Free trade is deeply rooted within North America's agricultural economy. Canada, Mexico, and the United States gradually removed thousands of barriers to regional agricultural trade from 1994 to 2008 as part of the North American Free Trade Agreement (NAFTA). From 1989 to 1993, Canada and the United States pursued agricultural trade liberalization through the Canada-U.S. Free Trade Agreement (CUSTA), which was then folded into NAFTA. Mexico also implemented a number of unilateral agricultural trade reforms in the early 1990s. When these initiatives are considered together, the NAFTA countries have completed a remarkable two decades of agricultural trade liberalization.

Since NAFTA's implementation in 1994, U.S. agricultural trade with Canada and Mexico has flourished

Billions of U.S. dollars



NAFTA = North American Free Trade Agreement.
Source: USDA, Economic Research Service using data from U.S. Department of Commerce, Census Bureau, Foreign Trade Statistics, as cited by USDA, Foreign Agricultural Service, *Global Agricultural Trade System*.

Regional agricultural trade has generally flourished since NAFTA's implementation, and the agricultural economies of the three NAFTA countries have become far more integrated. Between 1993 and 2010, annual U.S. agricultural exports to Canada rose from $5.3 billion to $16.9 billion, while corresponding exports to Mexico increased from $3.6 billion to $14.6 billion. Meanwhile, annual U.S. agricultural imports from Canada expanded from $4.7 billion to $16.2 billion, and agricultural imports from Mexico rose from $2.7 billion to $13.6 billion. For fiscal year 2012 (October 1, 2011, to September 30, 2012), U.S. agricultural exports to Canada and Mexico are forecast to reach $19.0 billion and $17.0 billion, respectively, and corresponding imports from Canada and Mexico are forecast to equal $19.8 billion and $17.6 billion, respectively. Of course, only a portion of these increases can be attributed to NAFTA, as other factors such as population growth, macroeconomic performance, and technological change have also affected regional agricultural trade.

What's next for the NAFTA countries now that the free-trade area is firmly established? Changes in the world's demographics and economics are likely to increase the relative importance of markets outside the NAFTA region. For instance, China recently surpassed Canada and Mexico to become the largest customer for U.S. agricultural exports. At the same time, opportunities for trade and investment are expanding within North America. To help consumers and producers capitalize on these prospects, the NAFTA governments are seeking more open trading relationships with non-NAFTA countries, as well as increased commerce within the North American free-trade area.

Where Are North America's New Agricultural Markets?

According to the U.S. Census Bureau, the world's population is projected to grow from 7.0 billion to 8.4 billion during 2012-32, with 93 percent of the increase occurring in non-NAFTA countries. Two

The NAFTA region is expected to see major demographic changes over the next two decades

Country	Total midyear population			Annual population growth rate			Median age, midyear		
	2012	2022	2032	2012	2022	2032	2012	2022	2032
		Millions			*Percent*			*Years*	
United States	316	348	380	0.96	0.92	0.84	37.0	37.9	38.8
Canada	34	37	39	0.78	0.65	0.44	41.2	43.1	44.6
Mexico	115	127	137	1.09	0.88	0.64	27.4	31.0	34.5

Source: USDA, Economic Research Service, using data from U.S. Department of Commerce, Census Bureau, *International Data Base*.

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continents account for 87 percent of the projected increase: Asia, due to its large current population, and Africa, with projected rapid population growth. In addition, real (inflation-adjusted) per capita income growth in several Asian countries is expected to average more than 5 percent per annum over the next 20 years, well above the average annual rates projected for the United States (1.77 percent), Canada (1.65 percent), and Mexico (2.08 percent).

Census projections also indicate that the NAFTA region will be a growing market. This growth will mainly be driven by the U.S., which, among the NAFTA countries, is expected to have the largest increase in population over the next decades. Between 2012 and 2032, the region's population is projected to increase by 64 million in the U.S., 22 million in Mexico, and 5 million in Canada. This anticipated growth will heighten the attractiveness of the U.S. market, not only to Canadian and Mexican producers, who enjoy duty-free access because of NAFTA, but also to U.S. producers.

The rates of population growth in each NAFTA country, however, are projected to slow over the next 20 years. For Canada, this deceleration will be particularly sharp, from 0.78 percent growth annually in 2012 to 0.44 percent 20 years later. Among the world's major agricultural exporters, Canada and the European Union are among the few that anticipate little increase in domestic demand in the coming two decades.

The median age of the population in each NAFTA country will also increase over the next two decades, particularly in Mexico. A 2007 ERS study of U.S. household food expenditures suggests that the aging of the population is likely to lower per capita spending on food and shift demand toward fruit and vegetables and away from eating at restaurants and other foodservice establishments.

In Mexico, however, the aging of the population will initially coincide with a reduced number of dependents (defined as children plus persons over age 65) per working-age adult, a development that could help to boost household incomes and food demand. In a 2005 study, *Building Human Capital in an Aging Mexico*, Richard Jackson emphasizes that the number of dependents in Mexico is projected to decline from roughly 80 per 100 working-age adults in 2005 to 65 in 2030 and then start to increase as the Mexican population ages.

According to the same study, Mexico's brief demographic dividend of fewer dependents per working-age adult may diminish pressures on social service budgets, facilitate higher savings rates and larger investments in education, foster a shift toward more capital-intensive economic activities, and decrease international migration—all factors that could lead to higher rates of economic growth. This, in turn, could increase levels of food spending per capita, which tends to rise with household income.

Looking Outward

Cognizant of the market opportunities that lie outside North America, all three NAFTA governments are participating in multilateral trade negotiations at the World Trade Organization and negotiating additional regional and bilateral trade agreements. One of the main U.S. regional initiatives is the Trans-Pacific Partnership (TPP), an effort to foster greater economic integration in the Asia-Pacific region. The TPP involves eight other countries: Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, and Vietnam. In May 2011, the trade ministers of the TPP countries expressed their goal of reaching the broad outlines of an agreement by November.

The United States also has signed trade agreements with Colombia (2006), Panama (2007), and South Korea (2007), and in October 2011, these agreements were approved by the U.S. Congress. Leading up to the agreement's submission to Congress, the United States worked closely with the governments of these countries on important issues associated with the agreements—labor rights with Colombia, tax information with Panama, and automotive trade with Korea.

Efforts to secure congressional approval of these agreements were also intertwined with the objective of securing a long-term extension of the Trade Adjustment Assistance (TAA) Program, which provides job training, income support, job search and relocation allowances, and other forms of assistance to U.S. workers who lost their jobs or whose hours of work and wages were reduced as a result of increased imports. Trade adjustment assistance was one governmental activity that facilitated U.S. adjustment to trade liberalization under NAFTA. A NAFTA-focused variant of the TAA Program—the NAFTA-Transitional Adjustment Assistance Program—was folded into the TAA Program in 2002.

Looking Inward

The NAFTA governments are seeking to build on the accomplishments of the past decade to improve the fluidity of regional cross-border economic activity. Four priorities relevant to agricultural trade are: (1) regulatory cooperation; (2) cross-border trucking; (3) dispute resolution mechanisms in the North American produce market; and (4) NAFTA's rules of origin.

Regulatory cooperation: The NAFTA governments are continuing efforts to harmonize sanitary, phytosanitary, and other regulations. Three bilateral initiatives—the High-Level Regulatory Cooperation Council (U.S.-Mexico), the Beyond the Border Working Group (U.S.-Canada), and the Regulatory Cooperation Council (U.S.-Canada)—frame some of the efforts underway to simplify and coordinate trade regulations among the NAFTA partners.

Previous examples of regulatory cooperation include:

- A "terms of reference" document signed in 2010 that outlines matters of equivalence (when a country recognizes another country's regulations as achieving the same level of protection as its own, even when the two countries' regulations are not identical), audit procedures, eligibility for exporting establishments, and communication channels between USDA's Food Safety and Inspection Service and Mexico's Servicio Nacional de Sanidad, Inocuidad, y Calidad Agroalimentaria (SENASICA);
- Enlistment of the North American Plant Protection Organization (NAPPO)—a forum in which the public and private sectors of the NAFTA countries work together on crafting science-based standards for protecting plant resources from regulated pests—to resolve some phytosanitary disputes; and
- The sharing of scientific studies and administrative evaluations among pesticide regulators and scientists in each NAFTA country.

Also, it is important to note that the United States is engaged in many other efforts toward greater regulatory coordination with its other agricultural trading partners.

Cross-border trucking: Restrictions on cross-border trucking continue to impede the smooth flow of agricultural products among the NAFTA countries. In July 2011, the U.S. and Mexican Governments agreed to establish a reciprocal, phased-in program that will authorize both Mexican and U.S. carriers to engage in cross-border, long-haul trucking operations. As part of this agreement, Mexico reduced by half the retaliatory tariffs on selected agricultural and nonagricultural products that it had imposed in retaliation for U.S. noncompliance with NAFTA's trucking provisions after the United States canceled a demonstration project for implementing these provisions.

When NAFTA was signed in 1992, the United States and Mexico agreed to allow persons from the other country to obtain operating authority to provide trucking services of this type by the year 2000, but the implementation of these provisions was seriously delayed. Currently, U.S. and Mexican truckers are required to transfer their trailers to short-haul drayage trucks located near the border, which then cross the border and deliver the trailers to other long-haul truckers on the opposite side. Cross-border, long-haul trucking operations are expected to lower shipping costs and shorten transit times associated with trucking cargo between the two countries.

Dispute resolution: The U.S. Government and the U.S. and Canadian private sectors have expressed their desire for the enactment of Canadian legislation that would protect produce suppliers from buyers that default on their payment obligations, something akin to the protections afforded by the Perishable Agricultural Commodities Act in the United States. Canada lacks a statute of this type, and the Canadian Government has commissioned a legal study to determine how such legislation would affect other Federal and Provincial laws already on the books.

NAFTA's rules of origin: The NAFTA governments are fine-tuning the agreement's rules of origin in order

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to facilitate trade. In a preferential trade agreement such as NAFTA, rules of origin determine whether a product originated in one of the countries covered by the agreement and thus whether that product qualifies for a preferential tariff, usually duty-free status in NAFTA's case.

Since 2003, the NAFTA Working Group on Rules of Origin (WGRO) has crafted four rounds of incremental changes to the accord's rules of origin that have been implemented by the NAFTA governments. Some of these changes directly apply to agriculture. For instance, modifications issued in 2009 allow for certain crushed or ground spices produced in the NAFTA region to qualify for duty-free status even when they were derived from spices (not crushed or ground) sourced outside the NAFTA region. In January 2011, the NAFTA Free Trade Commission instructed the WGRO to begin implementation of the fourth round of changes to the agreement's rules of origin and to consider the possibility of a fifth round.

Issues Separate From NAFTA Also Affect Agriculture

The fluidity of intra-NAFTA trade is affected by issues such as border security and immigration policy that are completely separate from the agreement. Complying with border security requirements sometimes creates challenges for companies participating in regional agricultural trade. According to a survey conducted by Taketo Murata in 2010 of 80 major Canadian firms that export food to the United States, 70 encountered higher costs in complying with the enhanced security measures following September 11, 2001, and 17 were unable to provide the same level of customer service as before. Despite challenges, 60 of the 80 surveyed firms indicated that their exports to the United States increased during the first decade of the 21st century.

Heightened security concerns over the past several years along the U.S.-Mexico border have complicated the inspection of live animal imports into the United States. In response, USDA's Animal and Plant Health Inspection Service and Mexico's SENASICA rerouted imports to different ports of entry and established temporary inspection points on the U.S. side of the border.

Cooperation by the NAFTA governments on security issues can energize efforts to work together on regulatory issues that affect regional agricultural trade. For instance, the Beyond the Border initiative with Canada, which has a prominent focus on security, includes activities related to livestock and animal product trade, and the High-Level Regulatory Cooperation Council with Mexico also contains a security component.

The desire to preserve national sovereignty, however, can conflict with efforts to improve the functioning of border institutions. The U.S. and Canadian Governments, for example, spent several years attempting to negotiate an agreement to move the cramped U.S. border inspection facility located on the Buffalo, NY, side of the Peace Bridge to a more spacious location on the Canadian side of the bridge. (The Buffalo, NY, Customs District accounted for 17 percent of U.S. agricultural imports from Canada in 2010.) These negotiations were abandoned in 2007 after the two sides failed to resolve a number of issues related to national sovereignty.

Further regulatory cooperation, institution of cross-border trucking between the United States and Mexico, improved dispute resolution mechanisms for produce marketers, and additional adjustments to NAFTA's rules of origin may reduce transaction costs and lower the risks associated with regional agricultural trade. This would allow producers, marketers, and consumers in each NAFTA country to respond more efficiently to market signals. While greater clarity in economic signaling in itself does not provide answers to the region's future challenges, it can provide a setting for better decisionmaking and a possible foundation for greater prosperity during the next two decades of regional free trade in North America and beyond. W

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NAFTA at 17: Full Implementation Leads to Increased Trade and Integration, by Steven Zahniser and Andrew Roe, WRS-1101, USDA, Economic Research Service, March 2011, available at: www.ers.usda.gov/publications/wrs1101/

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